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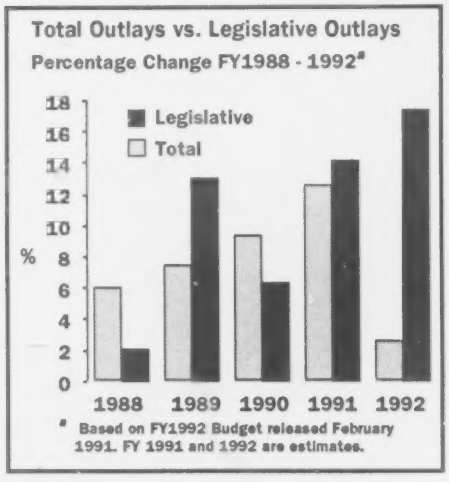
Tax Features

Legislative Branch Spending Will Top $2.5 Billion in FY'91

Pay Raise Helps Hike Congress's Price Tag to $1.2 Billion

On January 1, 1991, Members of the U.S. House of Representatives received a 25 percent increase in salary, pursuant to the Ethics



Reform Act of 1989, compounded with a 3.6 percent cost of living adjustment (COLA). The result was a salary boost from $96,600 to $125,100 per year. Senators received a 3.6 percent COLA, increasing their salaries from $98,400 to $101,900. These raises have contributed to the record-setting price that taxpayers will pay to fund the operations of the nation's legislative body during fiscal year 1991.

Overall spending on the legislative branch is estimated to rise $317.5 million in FY1991, hitting an all-time high of over $2.5 billion. While total federal spending is estimated to increase 12.6 percent this year, legislative branch spending will increase at an even faster rate of 14.2 percent.

The cost of Congress itself, now over $1.2 billion, has more than doubled since 1980 and

See Cost of Congress on page 5

Tax Foundation

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FRONT BURNER

Outlaw Retroactive Taxation

Senator David Boren

In our society, we ask the business community to shoulder many burdens. We ask that business comply with health regulations, environmental requirements, labor standards, and countless other measures to benefit society. However, sometimes we ask too much. Out-guessing the IRS is one of those tasks that taxpayers, whether individuals or businesses, can not be expected to do.

Sadly, it has become almost common practice for the IRS to offer what are known as "temporary" regulations, which require taxpayer compliance not from that day forward, but from the date the statute was first enacted. This retroactive taxation puts an unfair burden on business, reduces productivity, eliminates jobs and causes unnecessary confusion throughout the private sector.

For years, the IRS has enjoyed carte blanche authority in its regulation of taxpayer affairs. While the passage of the "taxpayers bill of rights" made some progress in putting taxpayers on an even footing with the IRS, more work remains to be done. The need to eliminate retroactive taxation is part of the taxpayers' unfinished agenda.

Retroactive regulation is unfair to taxpayers because it changes the rules in the middle of the game. Taxpayers who followed the rules are held hostage by the IRS, whose bureaucracy can make retroactive changes and hold the taxpayers responsible for not following standards they could never have been expected to know.

See Boren on page 2

Senator David Boren, Democrat from Oklahoma, serves on the Senate Finance Committee and chairs the Subcommittee on Taxation.

The opinions expressed in the Front Burner are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Boren from page 1

This year, I have joined with a few of my colleagues in the Senate Finance Committee to prevent the Treasury Department and the Internal Revenue Service from writing retroactive tax regulations. The "Taxpayer Regulatory Relief Act of 1991" (S. 532) would prohibit the IRS from enforcing a regulation during the window between the date the statute was first enacted and the time the agency issued temporary regulations.

"Sadly, it has become almost common practice for the IRS to offer what are known as "temporary" regulations, which require taxpayer compliance not from that day forward, but from the date the statute was first enacted."

I have been joined by Senator David Pryor (D-AR) and Senator Max Baucus (D-MT) in introducing this legislation which is very similar to S. 3161, introduced by Senator Pryor and myself in the 101st Congress.

"The "Taxpayer Regulatory Relief Act of 1991" (S. 532) would prohibit the IRS from enforcing a regulation during the window between the date the statute was first enacted and the time the agency issued temporary regulations."

The legislation requires that as long as taxpayers comply with new tax law in "reasonable good faith," they will be liable only in years after the regulations are issued. Congress will still have the option to grant an exception to this prohibition if we desire to authorize the Treasury Department to issue retroactive regulations with respect to a specific statutory change. The bill would apply with respect to any temporary or proposed regulation published as a final regulation after March 1, 1991.

So far, the measure has received enthusiastic support from the business community and from the grassroots. The U.S. Chamber of Commerce, the National Federation of Independent Businesses, the Small Business Legislative Council, and the National Small Business United all endorsed the measure.

It is clear that the business community realizes that the current IRS method is bad for the economy and has a chilling effect on legitimate business transactions. More money is probably lost to the treasury due to these fears than is gained by the taxes. Many small companies simply will not engage in certain transactions out of fear of retroactive taxation, and given the potential costs of IRS prosecution, this is a reasonable fear.

"More money is probably lost to the treasury due to these fears [of prosecution] than is gained by the taxes."

The average taxpayer is getting tired of unrealistic and arbitrary demands sent down by bureaucrats. I have received dozens of phone calls and letters from across the nation urging the bill's passage, and I have urged all my colleagues to consider the detrimental economic effects of retroactive taxation and to join me as co-sponsors.

"Many small companies simply will not engage in certain transactions out of fear of retroactive taxation, and given the potential costs of IRS prosecution, this is a reasonable fear."

As chairman of the Subcommittee on Taxation in the Finance Committee, I plan to push for hearings on this proposal to press for the bipartisan support needed to enact the measure into law.

Foundation Seminar To Analyze Code's Impact on Corporate Strength and Economic Growth

On May 22, 1991, the Tax Foundation will conduct a seminar in Washington, DC, entitled "Rebuilding the U.S. Industrial Base: The Role of Tax Policy in Economic Growth."

The seminar will feature for its keynote address Lawrence Lindsey, Special Assistant to the President for Policy Development and Associate Director for Domestic Economic Policy. Other panelists will be noted experts from business, government and academia.

Topics to be covered include the economic impact of increasing levels of corporate taxation, tax obstacles to service sector expansion, tax impediments to transborder investment, the level of taxation on foreign source income, and pro-growth tax policies, i.e., R&E tax policies, capital gains tax differential, and capital cost recovery issues.

The seminar will examine our current tax policies and develop a sound pro-growth tax agenda that will help insure economic strength in the long term. For additional information about attending, call Gretchen Geordiadis at 202-863-5454.

Now Available

A New Tax Foundation Issue Brief:

"Implications of U.S. Tax Policy for Treaty Partners"

by Lindy L. Paull

4 pp. $10 + $2 p/h; members: $5

and

A New Special Report:

"Federal Tax Burden by State"

by Paul G. Merski and Gregory Leong

8 pp. $10 + $2 p/h; members: $5

Implications of U.S. Tax Policy for Treaty Partners

By Lindy L. Paull

Lindy L. Paull

From January 9th through the 17th, I attended Tax Foundation-sponsored meetings in London, Paris, Brussels, and Bonn to explore the "Implications of U.S. Tax Policy for Treaty Partners." These comments are my observations on the European perspective; they are not intended to represent the views of the other participants or of the Tax Foundation.

At the Tax Foundation's international tax conference, it did not take long to discover the "hot buttons" of our European treaty partners:

- Unilateral overrides of tax treaties by the U.S.;
- Proposals to tax capital gains of foreign investors;
- Proposals to change the arm's length price standard for transactions between related companies;
- New reporting requirements for foreign-owned firms;
- New earnings stripping rules; and
- Unitary taxation by states.

Generally speaking, foreign officials and investors see our recent tax legislation as barriers to foreign investment in the U.S. Investors claim to have incurred substantial costs complying with the frequent changes to U.S. tax law, a complaint echoed by many domestic businesses, and question our desire for further investment by foreign-based firms.

Treaty Relations

European participants observed that the U.S. has initiated many tax treaties which provide order in the international business arena, protect against double taxation, and ensure each jurisdiction a fair share of tax. Now, they say, the U.S. is eroding other nations' confidence in tax treaties, and they point to a statement by Senator Sarbanes in June 1990 to the effect that, since the U.S. has overridden tax treaties in the past, our partners could expect overrides in the future.

Our partners want the U.S. to renegotiate, not override. Only rare circumstances such as a court's reinterpretation of law or abuse of the treaty justify override legislation.

Capital Gains of Foreign Investors

In 1989, the House-passed budget reconciliation bill would have taxed capital gains of foreign investors on the sale of a 10-percent-or-more interest in a U.S. company. The provision, dropped in conference, would have expressly overridden U.S. tax treaties. A similar proposal, without the treaty override feature, was introduced in 1990 by Congressmen Gephardt and Rostenkowski. Both proposals were cited by Europeans as examples of tax legislation that would create barriers to foreign investment in the U.S.

Transfer Pricing

European participants were unanimous in supporting arm's length pricing as the standard for related company transactions. They admit it can be troublesome but feel its problems have never been insurmountable. U.S. proposals to change it, such as the 1988 Internal Revenue Service white paper suggesting comparable uncontrolled prices, raise the spectre of possible double taxation to our treaty partners.

Reporting

In 1989, the U.S. Treasury was given authority to require information about the business activities of foreign-owned companies. Tougher penalties were added in 1990. European multinationals think the reporting rules have gone too far, and they worry about the cost of compliance and about safeguarding business secrets. Frequently charged with skirting U.S. tax law, they provided us with data compiled from I.R.S. Statistics of Income for 1984 through 1987, showing foreign-owned companies accounted for roughly six percent of all U.S. corporate assets and receipts, and paid about six percent of the U.S. corporate income tax collected.

European government officials, on the contrary, agreed with the policy underlying the U.S. reporting requirements and acknowledged that their countries had similar rules.

Earnings Stripping

I was left with the impression that the much ballyhooed earnings stripping rules have not in practice affected anyone. Companies are able to manage their related party debt to make sure the safe harbor debt-to-equity ratio is satisfied.

Unitary Tax

The recent decision of the California Court of Appeals holding the California unitary method of income taxation as applied to foreign multinational companies unconstitutional was obviously given high marks by the foreign investors attending the conference. (Barclays Bank International Ltd. v. Franchise Tax Board, November 30, 1990.)

European Community (EC 1992)

Because tax decisions require unanimous instead of majority vote, they are on a relatively slow track. In 1990, the EC Council approved three tax measures. The Mergers Directive sets up a unified regime for mergers, divisions, transfers of assets and exchanges of stock for companies in different member countries. Tax on gains from cross-border transfers are generally deferred under that directive. The Parent/Subsidiary Directive eliminates withholding tax on cross-border intercompany dividends. Finally, the Arbitration Convention establishes a procedure for tax authorities of the member countries to resolve double taxation disputes. With a few exceptions, these measures are scheduled to be implemented in 1992.

Lindy L. Paull is Minority Deputy Chief of Staff and Chief Tax Counsel for the Senate Finance Committee.

This article is excerpted from a four-page Issue Brief of the same title. Contact the Foundation for copies.

VIEWPOINT

With the current slowdown in the U.S. economy, what do you see as a top federal tax policy priority in 1991 to best ensure corporate strength and economic growth?

John J. Ross
General Tax Counsel
Chevron Corporation

Inaction is not usually viewed positively, particularly if it is inaction by the federal government. However, inaction ought to be a top priority when it comes to federal policy in 1991. Specifically, policymakers should refrain from increasing the current corporate income tax rate during a recessionary period.

The corporate tax rate reduction included in the 1986 Tax Reform Act was a trade-off. Numerous tax deductions and other tax benefits were deleted or restricted. Corporations lost the ability to use the investment tax credit and accelerated depreciation, both of which were substantial incentives for economic growth. The only significant benefit most corporations received in the 1986 bill, which was designed to raise corporate income taxes by $120 billion over five years, was rate reduction.

"Holding the rates . . . steady in 1991 should be an easy assignment for Congress and a pleasant change from the major tax bills American taxpayers saw virtually every year throughout the 1980s."

Concern over the recession is causing many economists to promote tax reductions. But additional measures to encourage economic growth must be weighed against the increasing federal budget deficit. The gravity of the deficit would seem to overshadow the possible benefits from any tax reduction to stimulate the economy. Even with the enactment of the 1990 Omnibus Budget Reconciliation Act, the fiscal year 1991 and 1992 deficits are expected to be the largest ever—estimated to exceed $300 billion in each of those two fiscal years. All possible steps, therefore, should be taken to reduce federal expenditures.

Federal Reserve Board Chairman Alan Greenspan urged Congress recently not to raise taxes to pay for the war. "Assessing the economic outlook is especially daunting at the present time," Greenspan argued. He noted that "the risks of making policy mistakes are high." Given the conflicting concerns of paying for the war, stimulating the economy, overcoming recession and avoiding inflation, it would seem only prudent for Congress to stay the course. Holding the rates and the entire tax structure steady in 1991 should be an easy assignment for Congress and a pleasant change from the major tax bills American taxpayers saw virtually every year throughout the 1980s.

Glenn White
Director of Tax & Assistant Secretary (retired)
Dow Chemical Company

In light of the current recession, it is important to consider what impact existing U.S. tax policy has on economic conditions. The reduced corporate rate structure, that has in some measure contributed to sustaining economic growth since 1986, will lose its effectiveness primarily because many corporations will be placed in the position of paying the Alternative Minimum Tax (AMT) in a recessionary period. Unfortunately, the AMT will raise taxes on the sector of the economy that will be creating the jobs necessary to bring the country out of a recession.

By definition the AMT has to create an effective tax rate higher than that which would have been imposed by the normal corporate income tax. Experience has taught us that tax increases imposed during a recession only lengthen and deepen the trough and increase the hardship on everyone.

While there may be an argument for the AMT when corporate earnings should be high as a result of a strong economy, that argument disappears when the economy is failing. For many corporations, the AMT operates as a tax on depreciation. At this point in time, national tax policy should help accelerate capital cost recovery, lower the cost of capital and stimulate investment. The effect of the AMT is to tax growth. Clearly the primary goal of fiscal policy during a recession should be to encourage growth. The perversity of the AMT is that it gives back the tax imposed in hard times

"The AMT will raise taxes on the sector of the economy that will create the jobs necessary to pull the country out of a recession."

as a credit in good times when the corporation otherwise would pay the normal corporate income tax.

Consequently the operation of the AMT should be suspended until the recession is over. Placing a surcharge on the effects of investment only increases the cost of capital, and dampens the ability to invest. We can no longer ignore the economic costs of investment-stifling tax policies.

Viewpoint *is designed to bring concise opinions from experts in tax and fiscal policy to the readers of* Tax Features *on subjects that are currently being debated by policymakers and the media. The opinions expressed are not necessarily those of the Tax Foundation. Editorial replies are encouraged.*

Cost of Congress from page 1

costs over seven times more than it did in 1970. The Senate will run $456.3 million ($4.6 million per senator), while the House will require $698.9 million ($1.6 million per representative). Joint activities of the House and Senate will cost an additional $106 million.

Congress maintains a number of legislative agencies, such as the Congressional Budget Office, General Accounting Office, and the Architect of the Capitol, each of which has its own budget. These will cost taxpayers $1.3 billion in 1991, 14.5 percent more than last year.

What does all this money buy? Taxpayers are primarily paying for four things: Congressional leadership, staff and administration; committees and subcommittees; and legislative agency personnel.

The U.S. Office of Personnel Management reports that the legislative branch now employs over 37,388 workers. Congress itself has 19,371 on the payroll — 7,322 in the Senate and 12,049 in the House.

"While this year's $2.5 billion legislative branch spending represents a 14.2 percent increase, 1992 spending is estimated to increase even faster, rising at a 17.5 percent clip for a total cost of $3 billion."

Congress's committee system is comprised of 20 committees and 87 subcommittees in the Senate, employing over 770 professional staff, plus 27 committees and 155 subcommittees in the House, with 1,271 professional staff attached. Adding in the joint committees brings the total to over 50 committees and 250 subcommittees in the congressional bureaucracy, paying a professional staff of over 2,100 people.

While this year's $2.5 billion legislative branch spending represents a 14.2 percent increase, 1992 spending is estimated to increase even faster, rising at a 17.5 percent clip for a total cost of $3 billion. Total federal spending for 1992 is projected to increase only 2.6 percent. See details in table at right.

FOUNDATION MESSAGE

Whose New World Order?

Dan Witt
Vice President

The 1991 edition of *State of the World* is out and Lester R. Brown, its lead author, concludes that during the decade of the '90s, tax policy promises to be the most effective instrument in solving the world's environmental problems. The unofficial bible of the environmental movement, *State of the World* is a compilation of articles on deforestation, global warming, waste disposal, etc. As part of their solutions to almost all these problems, the authors call for "green" taxes to punish environmentally destructive activities. In fact, green taxes are one of the linchpins in the environmentalists' version of the "new world order."

At the top of their list of tax targets is the energy industry, specifically the burning of carbon in coal, oil, and natural gas. At $100 per ton, taxing these fossil fuels is alleged to raise quite a bit of "green," about $130 billion annually. The authors suggest reducing income taxes commensurate with green tax revenue estimates, but practically speaking, green taxes are more likely to be collected on top of income taxes, not in place of them. Furthermore, green taxes would not be reliable revenue sources. Just as with other corporate taxes, the expected revenue is extremely difficult to estimate, making federal budgeting even more problematic than it already is.

A more serious weakness of green taxes than the difficulty they would cause for revenue estimating and federal budgeting is the issue of who would bear the burden of these well-intentioned taxes. The companies the public identifies with energy production are popular tax targets, but the fact is that *people* pay taxes, even corporate taxes. Customers, shareholders, and employees of those companies will do the paying. That's a big problem with corporate taxes in general — they take money out of the private economy, but it's hard to say who bears the burden. A basic principle of sound fiscal policy is that taxpayers should know who is being taxed. Green taxes do not meet that test.

While we are all hopeful of a better environment, tax policy simply cannot be the vehicle to achieve every societal goal. The purpose of taxes is not to micromanage the economy with subsidies and penalties, and restructuring our federal tax system is not the answer to environmental problems. If the "new world order" includes green taxes, we better stick with the old one.

Outlays for the Legislative Branch of the Federal Government by Unit

Selected Fiscal Years 1970-1991[a]

($Thousands)

Unit	1970	1980	1990	1991
Total	$343,147	$1,217,985	$2,230,497	$2,547,961
Congress, total	179,159	581,543	1,107,723	1,261,873
Senate	57,585	183,890	381,250	456,295
House of Representatives	108,279	324,569	585,080	698,945
Joint activities	13,295	73,084	141,393	106,633
Legislative agencies, total	163,988	636,442	1,122,774	1,286,088
Architect of the Capitol	18,797	89,496	128,253	252,716
Botanic Garden	620	1,583	2,475	3,795
Congressional Budget Office	-	12,101	18,266	21,438
General Accounting Office	69,857	201,192	362,254	384,585
Government Printing Office	34,141	115,747	120,440	90,003
Library of Congress	49,804	192,740	479,396	495,208
Office of Technology Assessment	-	11,131	18,329	20,789
U.S. Tax Court	2,972	9,703	26,608	31,790
Other	-	13,675	4,119	5,732
Deductions for offsetting receipts	-12,203	-10,926	-37,366	-19,968

[a] Data for 1991 are estimates from the FY 1992 Budget presented in February 1991.
Source: Office of Management and Budget.

Foundation Members Meet in Washington for Tax Policy Briefing

▲ *Michael J. Graetz, Deputy Assistant Secretary of the Treasury for Tax Policy, addresses Tax Foundation Program Committee.*

Foundation Co-Chairman James C. Miller III speaks to members assembled ▼ *at the Old Executive Office Building.*

From left at a Capitol Hill Club luncheon: William Dakin, Supervisory Tax Counsel, Mobil Corporation; Robert T. Matsui (D-CA), Member of the Ways and Means Committee; Dan Witt, Vice President of the Tax Foundation; and Byron L. Dorgan (D-ND), Member of the Ways and Means Committee. ▶

▲ *Congressman Robert T. Matsui, Democrat from California and member of the Ways and Means Committee, speaks at Capitol Hill luncheon.*

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